

THE PROBLEM OF THE RUPEE: ITS ORIGIN AND ITS SOLUTION

(HISTORY OF INDIAN CURRENCY & BANKING)

CHAPTER III Continued---

TABLE XVIII

DEVELOPMENT OF JUTE INDUSTRY AND TRADE

Growth	Average Annual of each Quinquennium				
	1870-71 to 1874- 75	1875-76 to 1879-80	1880-81 to 1884- 85	1885-86 to 1889-90	1890-91 to 1894-95
Exports—					
Raw, million cwt.	5.72	5.58	7.81	9.31	10.54
Gunny bags, millions	6.44	35.96	60.32	79.98	120.74
Cloth, million yds.		4.71	6.44	19.79	54.20
<i>Growth of Industry</i>					
Number of—					
Mills		21	21	24	26
Looms, 000 omitted		5.5	5.5	7	8.3
Spindles, 000 omitted		88	88	138.4	172.4
Persons employed, in thousands		38.8	38.8	52.7	64.3

The chief cause was said to be the inability of the English manufacturers to hold out in international competition. This inability to compete with the European rivals was attributed to the prevalence of protective tariffs and subsidies which formed an essential part of the industrial and commercial code of the European countries.

TABLE XIX

GROWTH OF AGRICULTURAL EXPORTS OF INDIA

	1868-69	1873-74	1877-78	1882-83	1887-88	1891-92
Wheat	100	637.41	2,313.47	5,152.36	4,914.37	11,001.44
Opium	100	118.38	123.83	122.47	120.20	116.82
Seeds	100	111.26	305.87	239.97	403.60	480.99

Rice	100	131.66	119.84	203.28	185.55	220.36
Indigo	100	116.91	121.57	142.17	140.76	126.33
Tea	100	169.35	293.17	507.25	775.09	1,075.75
Coffee	100	86.04	69.98	85.31	64.59	74.11

Nothing of the kind then existed in India, where trade was as free and industry as unprotected as any could have been, and yet the Lancashire cotton-spinner, the Dundee jute manufacturer and the English wheat-grower complained that they could not compete with their rivals in India. The cause, in this case, was supposed to be the falling exchange. So much were some people impressed by this view that even the extension of the Indian trade to the Far East was attributed to this cause. Already, it was alleged, the dislocation of the par of exchange between gold and silver had produced a kind of segregation of gold-using countries and silver-using countries to the exclusion of each other. In a transaction between two countries using the same metal as standard it was said the element of uncertainty arising from the use of two metals varying in terms of each other was eliminated. Trade between two such countries could be carried on with less risk and less inconvenience than between two countries using different standards, as in the latter case the uncertainty entered into every transaction and added to the expense of the machinery by which trade was carried on. That the Indian trade should have been deflected to other quarters where, owing to the existence of a common standard the situation trade had to deal with was immune from uncertainties, was readily admitted. But it was contended that there was no reason why, as a part of the segregation of commerce, it should have been possible for the Indian manufacturer to oust his English rival from the Eastern markets to the extent he was able to do (see Table XX, p. 432).

The causes which effected such trade disturbances formed the subject of a heated controversy. The point in dispute was whether the changes in international trade, such as they were, were attributable to the monetary disturbances of the time. Those who held to the affirmative explained their position by arguing that the falling exchange gave a bounty to the Indian producer and imposed a penalty on the English producer.

TABLE XX
EXPORTS OF COTTON GOODS TO EASTERN MARKETS

Years	Yarn, lbs., 000 omitted		Piece-goods, yds., 000 omitted	
	From India	From U. K.	From India	From U. K.
1877	7,927	33,086	15,544	394,489
1878	15,600	36,467	17,545	382,330

1879	21,332	38,951	22,517	523,921
1880	25,862	46,426	25,800	509,099
1881	26,901	47,479	30,424	587,177
1882	30,786	34,370	29,911	454,948
1883	45,378	33,499	41,534	415,956
1884	49,877	38,856	55,565	439,937
1885	65,897	33,061	47,909	562,339
1886	78,242	26,924	51,578	490,451
1887	91,804	35,354	53,406	618,146
1888	113,451	44,643	69,486	652,404
1889	128,907	35,720	70,265	557,004
1890	141,950	37,869	59,496	633,606
1891	169,253	27,971	67,666	595,258

DISTRIBUTION OF INDIAN TRADE

Annual Average for each Quinquennium in Millions of rupees

Countries	1875-76 to 1879-80			1880-81 to 1884-85		
	Imports	Exports	Total	Imports	Exports	Total
United Kingdom	323.68	278.15	601.83	434.45	344.22	778.67
China	14.05	132.27	146.32	19.23	134.94	154.17
Japan	.02	.33	.35	.19	2.09	2.28
Ceylon	5.74	22.97	28.71	5.35	16.37	21.72
Straits Settlement	10.83	26.11	36.94	15.88	33.65	49.53

Annual Average for each Quinquennium in Millions of rupees

Countries	1885-86 to 1889-90			1890-91 to 1894-95		
	Imports	Exports	Total	Imports	Exports	Total
United Kingdom	510.47	360.59	871.06	526.24	338.40	864.64
China	21.64	134.54	156.18	28.69	133.30	161.90
Japan	.25	7.27	7.52	1.51	14.44	15.95
Ceylon	5.86	20.56	26.42	6.42	31.18	37.60
Straits Settlement	20.09	42.54	62.63	23.32	52.56	75.88

The existence of this bounty, which was said to be responsible for the shifting of the position of established competitors in the field of international commerce, was based on a simple calculation. It was said that if the gold value of silver fell

the Indian exporter got more rupees for his produce and was therefore better off, while by reason of the same fact the English producer got fewer sovereigns and was therefore worse off. Put in this naive form, the argument that the falling exchange gave a bounty to the Indian exporters and imposed a penalty on the English exporters had all the finality of a rule of arithmetic. Indeed, so axiomatic was the formula regarded by its authors that some important inferences as to its bearing on the trade and industrial situation of the time were drawn from it. One such inference was that it stimulated exports from and hindered imports into the silver-using countries. The second inference was that the fall of exchange exposed some English producers more than others to competition from their rivals in silver-using countries. Now, can such results be said to follow from the fall of exchange? If we go behind the bald statement of a fall of exchange and inquire as to what determined the gold price of silver the above inferences appear quite untenable. That the ratio between gold and silver was simply the inverse of the ratio between gold prices and silver prices must be taken to be an unquestionable proposition. If therefore the gold price of silver was falling it was a counterpart of the more general phenomenon of the fall of the English prices which were measured in gold, and the rise of the Indian prices which were measured in silver. Given such an interpretation of the event of the falling exchange, it is difficult to understand how it can help to increase exports and diminish imports. International trade is governed by the relative advantages which one country has over another, and the terms on which it is carried on are regulated by the comparative cost of articles that enter into it. It is, therefore, obvious that there cannot be a change in the real terms of trade between countries except as a result of changes in the comparative cost of these goods. Given a fall in gold prices *all round*, accompanied by a rise in silver prices *all round*, there was hardly anything in the monetary disturbance that could be said to have enabled India to increase her exportation of anything except by diminishing her exportation or increasing her importation of something else. From the same view of the question of the falling exchange it follows that such a monetary disturbance could not depress one trade more than another. If the falling or rising exchange was simply an expression of the level of *general* prices, then the producers of all articles were equally affected. There was no reason why the cotton trade or the wheat trade should have been more affected by the fall of exchange than the cutlery trade.

Not only was there nothing in the exchange disturbance to disestablish existing trade relations in general or in respect of particular commodities, but there was nothing in it to cause benefit to the Indian producer and injury to the English producer. Given the fact that the exchange was a ratio of the two price-levels, it is difficult to see in what sense the English producer, who got fewer

sovereigns but of high purchasing power, was worse off than the Indian producer, who got more rupees but of low purchasing power. The analogy of Prof. Marshall was very apt. To suppose that a fall of exchange resulted in a loss to the former and a gain to the latter was to suppose that, if a man was in the cabin of a ship only ten feet high, his head would be broken if the ship sank down twelve feet into a trough. The fallacy consisted in isolating the man from the ship when, as a matter of fact, the same force, acting upon the ship and the passenger at one and the same time, produced like movements in both. In like manner, the same force acted upon the Indian producer and the English producer together, for the change in the exchange was itself a part of the more sweeping change in the general price-levels of the two countries. Thus stated, the position of the English and Indian producer was equally good or equally bad, and the only difference was that the former used fewer counters and the latter a larger number in their respective dealings.

A bounty to the Indian producer and a penalty to the English producer, it is obvious, could have arisen only if the fall of silver in England in terms of gold was greater than the fall of silver in terms of commodities in India. In that case the Indian producer would have obtained a clear benefit by exchanging his wares for silver in England and thus securing a medium which had a greater command over goods and services in India. But *a priori* there could be no justification for such an assumption. There was no reason why gold price of silver should have fallen at a different rate from the gold price of commodities in general, or that there should have been a great difference between the silver prices in England and in India. Statistics show that such *a priori* assumptions were not groundless. (See Table XXI).

TABLE XXI. MOVEMENTS OF PRICES, WAGES AND SILVER BETWEEN INDIA AND ENGLAND

Net Imports of Silver into India.		Index No. for Gold Price of Silver.	Years	Index No. for Silver Prices of Commodities in India.	Index No. for Wages in India.	Index No. for Gold Prices of Commodities in England.	Index No. for Wages in England.
Years.	Amount. Rs.						
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1871-72	6,587,296	99.7	1871	100		100	100
1872-73	739,244	99.2	1872	105	—	109	105.8

1873-74	2,530,824	97.4	1873	107	100	III	112
1874-75	4,674,791	95.8	1874	116	101	102	113
1875-76	1,640,445	93.3	1875	103	97	96	111.6
1876-77	7,286,188	86.4	1876	107	98	95	110
1877-78	14,732,194	90.2	1877	138	97	94	109.8
1878-79	4,057,377	86.4	1878	148	99	87	107
1879-80	7,976,063	84.2	1879	135	100	83	105.8
1880-81	3,923,612	85.9	1880	117	99	88	106.5
1881-82	5,381,410	85.0	1881	106	99	85	106.5
1882-83	7,541,427	84.9	1882	105	100	84	106.5
1883-84	6,433,886	83.1	1883	106	102	82	108
1884-85	7,319,581	83.3	1884	114	101	76	109
1885-86	11,627,028	79.9	1885	113	106	72	108
1886-87	7,191,743	74.6	1886	110	105	69	107
1887-88	9,319,421	73.3	1887	III	114	68	108
1888-89	9,327,529	70.4	1888	119	112	70	109.8
1889-90	11,002,078	70.2	1889	125	112	72	113
1890-91	14,211,408	78.4	1890	125	113	72	118
1891-92	9,165,684	74.3	1891	128	118	72	118
1892-93	12,893,499	65.5	1892	141	110	68	117.4
1893-94	13,759,273	58.5	1893	138	119	68	117.4

It is obvious that if silver was falling faster than commodities, and if silver prices in India were lower than silver prices in England, we should have found it evidenced by an inflow of silver from England to India. What were the facts ? Not only was there no extraordinary flow of silver to India, but the imports of silver during 1871-93 were much smaller than in the twenty years previous to that period. This is as complete a demonstration as could be had of the fact that the silver prices in India were the same as they were outside, and consequently the Indian producer had very little chance of a bounty on his trade.

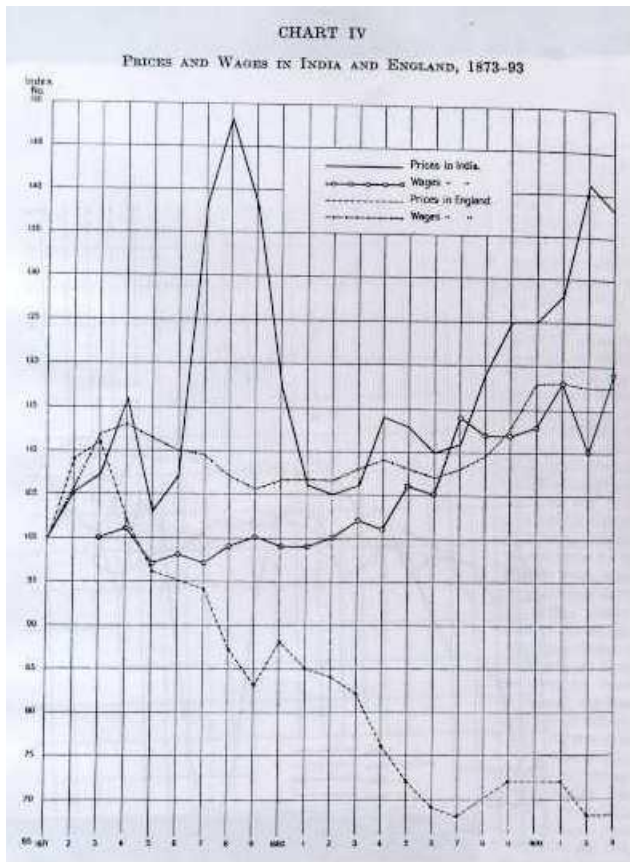
Although such must be said to be the *a priori* view of the question, the Indian producer was convinced that his prosperity was due to the bounty he received. Holding such a position he was naturally opposed to any reform of the Indian currency, for the falling exchange which the Government regarded a curse he considered a boon. But however plausible was the view of the Indian producer, much sympathy would not have been felt for it had it not been coupled with a notion, most commonly held, that the bounty arose from the *export trade*, so that it became an article of popular faith that the fall of exchange was a source of gain to the *nation as a whole*. Now was it true that the bounty arose from the

export trade ? If it were so, then every fall of exchange ought to give a bounty. But supposing that the depreciation of silver had taken place in India *before* it had taken place in Europe could the fall of exchange thus brought about have given a bounty to the Indian exporter ? As was explained above, the Indian exporter stood a chance of getting a bounty only if with the silver he obtained for his produce he was able to buy more goods and services in India. To put the same in simpler language, his bounty was the difference between the price of his product and the price of his outlay. Bearing this in mind, we can confidently assert that in the supposed case of depreciation of silver having taken place in India first, such a fall in the Indian exchange would have been accompanied by a penalty instead of a bounty on his trade. In that case, the exporter from India would have found that though the Indian exchange, i.e. the gold price of silver, had fallen, yet the ratio which gold prices in England bore to silver prices in India had fallen more, i.e. the price he received for his product was smaller than the outlay he had incurred. It is not quite established whether silver had fallen in Europe before it had fallen in India.* But even if that were so the possibility of a penalty through the fall of exchange proves that the bounty, if there was any, was not a bounty on the export trade as such, but was an outcome of the disharmony between the general level of prices and the prices of particular goods and services within the country, and *would have existed* even if the country had no export *trade*.

Thus the bounty was but an incident of the general depreciation of the currency. Its existence was felt because prices of *all* goods and services in India did not move in the same uniform manner. It is well known that at any one time prices of certain commodities will be rising, while the general price level is falling. On the other hand, certain goods will decline in price at the same time that the general price-level is rising. But such opposite movements are rare. What most often happens is that prices of some goods and services, though they move in the same direction, do not move at the same pace as the general price level. It is notorious that when general prices fall wages and other fixed incomes, which form the largest item in the total outlay of every employer, do not fall in the same proportion; and when general prices rise they do not rise as fast as general prices, but generally lag behind. And this was just what was happening in a silver-standard country like India and a gold-standard country like England during the period of 1873-93 (see Chart IV).

CHART IV

PRICES AND WAGES IN INDIA AND ENGLAND, 1873-93



Prices had fallen in England, but wages had not fallen to the same extent. Prices had risen in India, but wages had not risen to the same extent. The English manufacturer was penalised, if at all, not by any act on the part of his Indian rival, but by reason of the wages of the former's employees having remained the same, although the price of his products had fallen. The Indian producer got a bounty, if any, not because he had an English rival to feed upon, but because he did not have to pay higher wages, although the price of his product had risen.

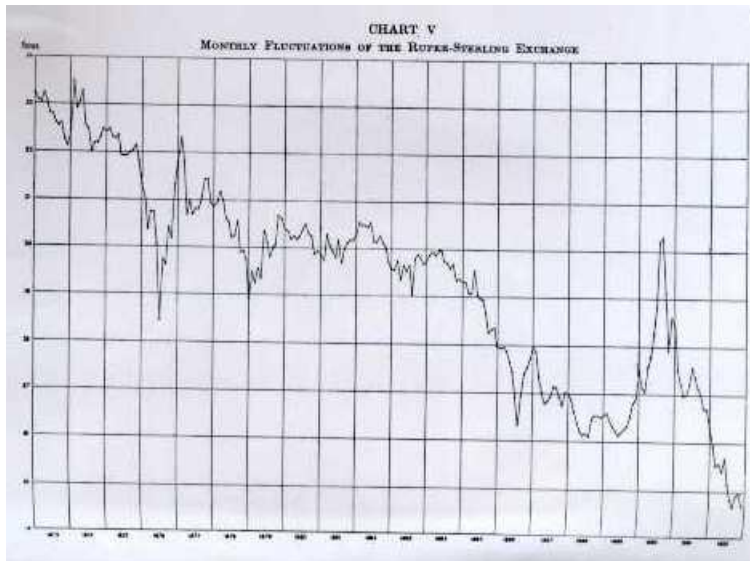
The conclusion, therefore, is that the failing exchange could not have disturbed established trade relations or displaced the commodities that entered into international trade. The utmost that could be attributed to it is its incidence in economic incentive. But in so far as it supplied a motive force or took away the incentive, it did so by bringing about changes in the social distribution of wealth. In the case of England, where prices were falling, it was the employer who suffered ; in the case of India, where prices were rising, it was the wage-earner who suffered. In both cases there was an injustice done to a part of the community and an easy case for the reform of currency was made out. The need for a currency reform was recognised in England ; but in India many people

seemed averse to it. To some the stability of the silver standard had made a powerful appeal, for they failed to find any evidence of Indian prices having risen above the level of 1873. To others the bounty of the falling exchange was too great a boon to be easily given away by stabilising the exchange. The falsity of both the views is patent. Prices in India did rise and that, too, considerably. Bounty perhaps there was, but it was a penalty on the wage-earner. Thus viewed, the need for the reform of Indian currency was far more urgent than could have been said of the English currency. From a purely psychological point of view there is probably much to choose between rising prices and falling prices. But from the point of view of their incidence on the distribution of wealth, very little can be said in favour of a standard which changes in its value and which becomes the *via media* of transferring wealth from the relatively poor to the relatively rich. Scope said: "Without stability of value money is a fraud." Surely, having regard to the magnitude of the interests affected, depreciated money must be regarded as a greater fraud. That being so, the prosperity of Indian trade and industry, far from being evidence of a sound currency, was sustained by reason of the fact that the currency was a diseased currency. The fall of exchange, in so far as it was a gain, registered a loss to a large section of the Indian people with fixed incomes who suffered from the instability of the silver standard equally with the Government and its European officers.

So much for the fall of silver. But the financial difficulties and social injustices it caused did not sum up the evil effects produced by it. Far more disturbing than the fall were the fluctuations which accompanied the fall (see Chart V).

CHART V

MONTHLY FLUCTUATIONS OF THE RUPEE-STEHLING EXCHANGE



The fluctuations greatly aggravated the embarrassment of the Government of India caused by the fall in the exchange value of the rupee. In the opinion of the Hon. Mr. Baring (afterwards Lord Cromer),

" It is not the fact that the value of the rupee is, comparatively speaking, low that causes inconvenience. It would be possible, although it might be exceedingly troublesome, to adjust the Indian fiscal system to a rupee of any value. What causes inconvenience alike to Government and to trade is that the value of the rupee is unstable. It is impossible to state accurately in Indian currency what the annual liabilities of the Government of India are. These liabilities have to be calculated afresh every year according to the variations which take place in the relative value of gold and silver, and a calculation which will hold good for even one year is exceedingly difficult to make."

Owing to such fluctuations, no rate could be assumed in the Budget which was likely to turn out to be the true market rate. As matters stood, the rate realised on an average during a particular year differed so widely from the Budget rate that the finances of the Government became, to employ the phraseology of a finance minister, a "veritable gamble." How greatly the annual Budget must have been deranged by the sudden and unprovided for changes in the rupee cost of the sterling payments Table XXII on page 442 may help to give some idea.

If Government finance was subjected to such uncertainties as a result

of exchange fluctuations, private trade also became more or less a matter of speculation. Fluctuations in exchange are, of course, a common incident of international trade. But if they are not to produce discontinuity in trade and industry there must be definite limits to such fluctuations. If the limits are ascertainable, trade would be reasonably certain in its calculation, and speculation in exchange would be limited within the known limits of deviations from an established par. Where, on the other hand, the limits are unknown, all calculations of trade are frustrated and speculation in exchange takes the place of legitimate trading. Now, it is obvious that fluctuations in the exchange between two countries will be limited in extent if the two countries have the same standard of value.

TABLE XXII
FLUCTUATIONS OF EXCHANGE AND FLUCTUATIONS IN THE
RUPEE COST OF GOLD PAYMENTS

Financial Year.	Estimated Rate of Exchange on which the Budget of the Year was framed.		Rate of Exchange actually realised on the Average during the Year.		Changes in the Rupee Cost of Sterling Payments consequent upon Changes between the Estimated and the Realised Rates of Exchange.	
					Increase.	Decrease.
	s.	d.	s.	d.	Rs.	Rs.
1874-75	1	10.375	1	10-156	15,91,764	—
1875-76	1	9.875	1	9-626	19,57,917	—
1876-77	1	8.5	1	8-508	—	76,736
1877-78	1	9.23	1	8-791	38,43,050	—
1878-79	1	8.4	1	7-794	56,87,129	—
1879-80	1	7	1	7-961	—	84,40,737
1880-81	1	8	1	7-956	4,24,722	—
1881-82	1	8	1	7-895	10,17,482	—
1882-83	1	8	1	7-525	37,46,890	—
1883-84	1	7.5	1	7-536	—	3,62,902
1884-85	1	7.5	1	7-308	18,97,307	—
1885-86	1	7	1	6-254	56,82,638	—
1886-87	1	6	1	5-441	65,17,721	—
1887-88	1	5.5	1	4-898	71,90,097	—

1888-89	1	4.9	1	4-379	77,98,400	—
1889-90	1	4.38	1	4-566	—	27,31,892
1890-91	1	4.552	1	6-09	—	2,35,51,744
1891-92	1	5.25	1	4-733	80,09,366	—

Where there is no such common standard of value the limits, though they exist, are too indefinite to be of much practical use. The rupture of the fixed par of exchange, having destroyed a common standard of value between gold and silver countries, removed the limits on the exchange fluctuations between such countries. As a result of such variations in the value of the standard measure, trade advanced by "rushes and pauses," and speculation became feverishly active

That progress of trade depends on stability is a truism which seldom comes home until it is denied in fact. It is difficult to appreciate its importance to healthy enterprise when government is stable, credit is secure, and conditions are uniform. And yet so great is the handicap of instability that everywhere businessmen have been led by a variety of devices to produce stability in domains enveloped by uncertainty. Everywhere there have grown up business barometers forewarning business men of impending changes and so enabling them to forearm against them by timely changes in their operations. The whole of insurance business is aimed at giving stability to economic life. The necessity which compelled all regularly established Governments to maintain standard measures by which the true proportion between things as to their quantities might be ascertained and dealings in them regulated with certainty was motivated by the same purpose. The meticulous precision with which every civilised country defines its standard measures, and the large machinery it maintains to preserve them from deviation, are only evidences of the great importance that an economic society must continue to attach to the matter of providing precision of expression and assurance of fulfilment with regard to the contracts entered into by its members in their individual or corporate capacities.

Important as are the standard measures of a community, its measures of a community, its measure of value is by far the most important of them all. The measures of weight, extension, or volume enter only into particular transactions. If the pound, the bushel, or the yard were altered the evils would be comparatively restricted in scope. But the measure of value is all-pervading.

"There is no contract," Peel declared. "public or private, no

engagement national or individual, which is unaffected by it. The enterprises of commerce, the profits of trade, the arrangements made in all domestic relations of society, the wages, of labour, pecuniary transactions of the highest amount and of the lowest, the payment of national debt, the provision for national expenditure, the command which the coin of the smallest denomination has over the necessaries of life, are all affected "

by changes in the measure of value. This is because every contract, though ultimately a contract in goods, is primarily a contract in value. It is, therefore, not enough to maintain constancy in the measures of weight, capacity, or volume. A contract as one of goods may remain exact to the measure stipulated, but may nevertheless be vitiated as a contract in values by reason of changes in the measure of values. The necessity of preserving stability in its measure of value falls on the shoulders of every Government of an orderly society. But its importance grows beyond disputes as society advances from status to contract. The conservation of the contractual basis of society then becomes tantamount to the conservation of an invariable measure of value.

The work of reconstituting a common measure of value in some form or other, which those misguided legislators of the seventies helped to destroy, it was found, could not be long delayed with impunity. The consequences that followed in the wake of that legislation, as recounted before, were too severe to allow the situation to remain unrectified. That efforts for reconstruction should have been launched before much mischief was done only shows that a world linked by ties of trade will insist, if it can, that its currency systems must be laid on a common gauge.

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